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In the Supreme Court of the United States

OCTOBER TERM, 1979

D. DOYLE MIZE AND FARNHAM CORPORATION,
PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the court of appeals erred in remanding for further consideration the district court's denial of injunctive relief after holding that the district court granted a dismissal motion under Fed. R. Civ. P. 41(b) based on the erroneous conclusion that the evidence submitted by the Commission did not establish a violation of law.

2. Whether the court of appeals erred in reversing the district court's holding that an undeniably significant proposed corporate event need not be disclosed as a material fact under the federal securities laws because it was not a "final plan," even though the proposed event was very likely to occur.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. B) is reported at 615 F. 2d 1046. The judgment, findings of fact and conclusions of law of the district court (Pet. App. A) are not officially reported.

JURISDICTION

The judgment of the court of appeals was entered on April 23, 1980. A petition for rehearing was denied on May 21, 1980. The petition for a writ of certiorari was filed on August 13, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES, REGULATIONS AND RULE INVOLVED

The pertinent statutory provisions and regulations are set forth in Appendix C to the petition. Fed. R. Civ. P. 41(b) appears in the Appendix to this brief.

STATEMENT

The Securities and Exchange Commission ("Commission") instituted this action against D. Doyle Mize, Farnham Corporation and others[1] in the United States District Court for the Southern District of Texas alleging

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[1]The complaint named the following parties as defendants in this action: D. Doyle Mize, Southdown, Inc., Valhi, Inc., Farnham Corporation, Leland McCarthy and Richard McCarthy. The McCarthys, Valhi, Inc., and Southdown, Inc., consented, without admitting or denying the allegations in the complaint, to the entry of permanent injunctions against further violations of the securities laws. Southdown, Inc., also consented to the establishment and maintenance of various procedures designed to prevent future securities laws violations (Pet. App. B-1).

violations of antifraud[2] and tender offer[3] provisions of the federal securities laws. The Commission sought to enjoin each of the defendants from further violations of these provisions (Pet. App. B-1). The substance of the Commission's complaint was that petitioner Mize, who was chairman of the board of directors and chief executive officer of Southdown, Inc. ("Southdown"), and later of Valhi, Inc. ("Valhi"), a wholly owned subsidiary of Southdown, and certain of his business associates made repeated undisclosed attempts to gain personal voting control of Valhi at prices below book value (Pet. App. B-2). In order to effectuate this scheme the defendants filed with the Commission and disseminated to the public various documents that contained affirmative misstatements and omitted material facts needed to avoid deception. *Ibid.*

1. During the early 1970's, Southdown, a publicly-held Louisiana corporation, was engaged through its subsidiaries in a wide range of business activities, including cement manufacturing and agricultural operations (Pet. App. B-2). The agricultural operations were conducted through its Valhi subsidiary. *Ibid.* In 1971, the Southdown board of directors determined that Valhi was financially incompatible with its other business endeavors and proposed to divide Southdown into separate agricultural and manufacturing entities having different operating characteristics and capital requirements (Pet. App. B-2 to B-3). After several unsuccessful attempts to accomplish

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[2]Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a); Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5.

[3]Sections 14(d) and 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. 78n(d) and 78n(e), and Rule 14d-1 thereunder, 17 C.F.R. 240.14d-1.

this goal, the Southdown board unanimously approved a "spin-off" of Valhi from Southdown by a pro-rata distribution of Valhi's common stock to Southdown's shareholders as a dividend. Southdown issued a press release announcing the Board's action and the filing of the required registration statement and accompanying prospectus with the Commission (Pet. App. B-3). On May 13, 1975, the spin-off was consummated by the distribution of Valhi stock as a dividend to Southdown common shareholders. Without making any disclosure of his activities, petitioner Mize attempted to gain control of Valhi during the period immediately prior to and following the May 1975 spin-off.

2. During the early fall of 1974, Charles Peterson, a former president of National Alfalfa Dehydrating & Milling Company ("National Alfalfa"), expressed interest in having Southdown or one of its subsidiaries purchase his 51% block of National Alfalfa stock which, at that time, was pledged to secure a $4.5 million loan (Pet. App. B-5). Peterson sought to sell his stock for an amount sufficient to repay his loan obligation and to obtain an equity interest in the entity that purchased his stock. *Ibid.* Southdown expressed interest in this proposal and drafted a preliminary purchase agreement for the stock but, in October 1974, negotiations broke down because of disclosure requirements that could not be met. *Ibid.* On several occasions during the winter of 1974-1975, however, petitioner Mize reaffirmed Southdown's interest in National Alfalfa and indicated that future negotiations with Peterson might be possible (Pet. App. B-5 to B-6).

On March 27, 1975, the day that the Southdown board approved and announced the Valhi spin-off, petitioner Mize resigned as an officer and director of Southdown and became chairman of the board of directors and chief

executive officer of Valhi (Pet. App. B-6). In April 1975, petitioner Mize prepared a 27-page memorandum entitled "Valhi/NA/CP" that detailed a proposal involving a series of transactions whereby Valhi would acquire Peterson's stock in National Alfalfa and Mize and his associates would acquire control of Valhi. The proposal provided that (*ibid.*):

1. Valhi would issue all of the shares of a new class of preferred convertible voting stock to Peterson in exchange for his National Alfalfa stock;

2. Peterson would deliver the Valhi preferred convertible voting stock to Farnham Corporation (a newly formed corporation) in exchange for (a) $7 million which he would use to pay off his loan secured by the National Alfalfa stock and (b) a 24.5% ownership interest in Farnham Corporation;

3. Mize and two of his associates, who were the operating principals of Valhi, would transfer to Farnham Corporation approximately $2.25 million in assets in exchange for which Mize would receive 26.5% ownership interest in Farnham and each of his associates would receive 24.5%;

4. Farnham Corporation would borrow the $7 million to be paid to Peterson by pledging as collateral the Valhi preferred stock which it would obtain from Peterson; and

5. Valhi would declare dividends on its preferred stock and Farnham would use these monies to repay the $7 million loan.

Thus, at the conclusion of this series of events, petitioner Mize and his associates would own 75.5% of Farnham

Corporation, which in turn would own all of the shares of Valhi's preferred convertible voting stock (constituting voting control of Valhi), and Valhi would have voting control of National Alfalfa.[4]

Petitioner Mize personally delivered the "Valhi/NA/CP" proposal to Peterson on April 15, 1975. Peterson expressed his willingness to proceed with the deal if Mize could obtain the necessary financing. However, because he was anxious to pay off the loan encumbering his National Alfalfa stock, Peterson indicated that he would not cease in his efforts to find a buyer for his stock other than Valhi (Pet. App. B-6 to B-7).

Petitioner Mize immediately set out to obtain the necessary financing. On April 25, 1975, he and his associates met with representatives of a California bank, presented the proposal and inquired whether the bank would lend Farnham Corporation the $7 million to be exchanged with Peterson for the Valhi stock. On May 6, 1975, the bank representatives prepared a written loan report concluding that "[a]pproval is highly recommended." On May 13, 1975, senior officers at the bank's headquarters advised Mize that the bank would approve the loan, provided that the other portions of the proposal set forth in the Valhi/NA/CP memorandum were completed (Pet. App. B-7, B-16).

Although these negotiations concerning the Peterson proposal occurred contemporaneously with the considera-

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[4]The acquisition by Valhi of Peterson's 51% block of National Alfalfa stock was the first step in a plan to acquire all the stock of National Alfalfa. Following the purchase of Peterson's stock, Valhi was scheduled to make a cash tender offer for the balance of the National Alfalfa stock owned by persons other than Peterson or, alternatively, to merge Valhi and National Alfalfa (Pet. App. B-6).

tion by Southdown's directors of the spin-off of Valhi, neither the registration statement filed with the Commission nor the prospectuses mailed to Southdown's shareholders made any mention of the transaction.[5] Those documents stated affirmatively that no plans had been formulated for the issuance of Valhi preferred stock or the payment of dividends by Valhi to its shareholders.

In May 1975, a number of Southdown shareholders instituted lawsuits seeking to enjoin the Valhi spin-off for reasons unrelated to the Peterson transaction. On May 15, 1975, a temporary restraining order was entered in those suits prohibiting the distribution of the Valhi shares as a dividend by Southdown. After the restraining order was entered, however, petitioner Mize concluded that the proposal set forth in the Valhi/NA/CP memorandum was no longer viable, and he abandoned the plan altogether. The temporary restraining order subsequently was dissolved, and the Valhi spin-off was consummated on May 28, 1975 (Pet. App. B-7).

As petitioner Mize testified at trial, the Peterson proposal would have been consummated but for the shareholder suits (Pet. App. B-16 to B-17; emphasis omitted):

> Q. As far as your particular Peterson deal would have gone through had it not been for the lawsuits in connection with the spinoff?
>
> * * * * *
>
> A. I believe it would have gone through.

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[5]Although the prospectus was supplemented on May 13, 16, and 24, 1975, none of those supplements contained any reference to the Peterson deal (Ex. 107-109). "Ex." refers to the volume of Exhibits filed in the court of appeals.

3. In July 1975, Contram Corporation made a tender offer for the newly spun-off outstanding shares of Valhi. Upon learning of this development, petitioner Mize and his associates formed Farnham Corporation for the purpose of making a counter-tender offer for the Valhi stock. In connection with this attempt, Farnham Corporation, pursuant to the Securities Exchange Act,[6] filed a Schedule 13D statement with the Commission and distributed tender offer materials to the Valhi shareholders. None of these offering materials disclosed petitioner Mize's previous unsuccessful attempts to gain control of Valhi (Pet. App. B-7 to B-8).[7]

4. After the Commission presented the foregoing evidence in its case-in-chief, petitioner Mize and Farnham Corporation moved for a judgment of dismissal on the merits. The district court granted the motion, holding that the Commission had not proved that the defendants violated the securities laws or that there was a reasonable likelihood that the defendants were about to engage in violations of those laws (Pet. App. A-3, A-5). The district court characterized Mize's attempt to gain control of Valhi as mere "ideas" in the formative stage as opposed to a "final plan," concluding that it had never reached a sufficient degree of maturity to be a material fact and thus to require disclosure (Pet. App. A-5).

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[6]Section 13(d) of the Securities Exchange Act of 1934, 15 U.S.C. 78m(d).

[7]On July 29, 1975, Contram Corporation filed a lawsuit in federal district court seeking to enjoin the Farnham Corporation counter tender offer. The district court issued an injunction and Contram ultimately was successful in acquiring 51% of the Valhi stock (Pet. App. B-8).

The court of appeals reversed in part the district court's grant of judgment in favor of petitioners. Although it agreed with the district court that the Peterson proposal was not consummated, and accepted the standard of law applied by the district court as enunciated in *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976), the court of appeals held that the district court erred in concluding that the Peterson proposal would not be important to a reasonable shareholder of Southdown considering the Valhi spin-off. In so concluding, the court of appeals balanced the probability that the proposal would be consummated and the anticipated magnitude of the event in light of the totality of the company's activity (Pet. App. B-15 to B-17). It held that the failure to disclose the proposal or to amend certain statements in the registration statement and prospectus made those documents false and misleading (Pet. App. B-17). The court also held that the tender offer materials of Farnham Corporation used in connection with its counter-tender offer for Valhi should have disclosed the previous unsuccessful attempt by petitioner Mize to gain control of Valhi. *Ibid.* The court of appeals remanded the case to the district court for further consideration. It also directed the district court to reconsider the question whether the defendants are likely to engage in future violations of the securities laws in light of its determination that past violations did occur (Pet. App. B-18).

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court. Further review by this Court is therefore unwarranted.

1. Petitioners argue (Pet. 7-10) that the decision of the court of appeals, which reversed the judgment of the

district court and held on the record before it that a violation of the federal securities laws was established, deprived them of due process of law because they have not yet had an opportunity to present any evidence in defense. This contention is premature. The Commission does not dispute petitioners' right to introduce any relevant evidence on remand before the district court, nor does the decision of the Fifth Circuit preclude them from doing so. Rule 41(b) of the Federal Rules of Civil Procedure and the decisions of this Court and the Fifth Circuit confirm that, on remand after reversal of a judgment granting involuntary dismissal on the merits, defendants are not barred from presenting relevant evidence.[8] See, *e.g.*, *United States* v. *United States Gypsum Co.*, 340 U.S. 76, 85 (1950); *Riegel Fiber Corp.* v. *Anderson Gin Co.*, 512 F. 2d 784, 793 (5th Cir. 1975). In such situations, the district court should proceed with the case exactly as though the defendant's motion for dismissal had been denied. *Ingraham* v. *Wright*, 498 F. 2d 248, 265 (5th Cir. 1974), affirmed on other grounds, 430 U.S. 651 (1977).

This principle is illustrated by *United States* v. *United States Gypsum Co.*, 333 U.S. 364 (1948), in which this Court reversed a dismissal under Fed. R. Civ. P. 41(b) of an action brought to restrain a violation of the Sherman Act, holding that the record before it established a clear violation of the Act and remanding the case for further

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[8]While the district court should not compel the plaintiff to present its case a second time (*United States* v. *United States Gypsum Co.*, 333 U.S. 364, 402 n.20 (1948)), the plaintiff should be allowed to supplement its evidence either in a retrial of its case-in-chief or in rebuttal. See *Riegel Fiber Corp.* v. *Anderson Gin Co.*, 512 F. 2d 784, 793 (5th Cir. 1975); *Ingraham* v. *Wright*, 498 F. 2d 248, 265 (5th Cir. 1974), affirmed on other grounds, 430 U.S. 651 (1977); *White* v. *Rimrock Tidelands, Inc.*, 414 F. 2d 1336, 1340 & n.7 (5th Cir. 1969).

proceedings. 333 U.S. at 401-402. On remand, the defendants were free to introduce any evidence from which they might be found not to have violated the Act. See *United States* v. *United States Gypsum Co.*, *supra*, 340 U.S. at 85. In the present case, the petitioners likewise are not precluded from introducing evidence on remand concerning the materiality of the Peterson transaction. Accordingly, petitioners' claim that their right to due process has been violated is premature and not ripe for review.[9]

2. Petitioners further argue (Pet. 11-13) that the decision of the court of appeals conflicts with *Aaron* v. *SEC*, No. 79-66 (June 2, 1980), because they have not had an opportunity to show lack of scienter. However, under the principles summarized above, they are free to present such evidence on remand. In any event, petitioners did not raise the issue of scienter on appeal, nor did the court of appeals consider it. Thus, petitioners should not be heard to raise that issue for the first time in this Court.

3. The court of appeals held that, although the district court selected the appropriate legal standard for determining materiality and the district court's findings of fact were not clearly erroneous, the district court erred in concluding that the Peterson proposal was not material. In so holding, the court of appeals adhered to established principles governing appellate review of questions of

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[9]Petitioners also argue (Pet. 9) that they may be collaterally estopped from litigating the issue of past violations of the federal securities laws in private lawsuits. However, petitioners have not been denied an opportunity to contest that issue, either in this proceeding or in any private suit. Should the district court make a finding adverse to petitioners on remand, and should it later be alleged in a private lawsuit that they are collaterally estopped from contesting that finding, the district court in the private lawsuit will have broad discretion to determine whether the doctrine of collateral estoppel should be applied. *Parklane Hosiery Co.* v. *Shore*, 439 U.S. 322, 331 (1979).

materiality, which may be resolved "as a matter of law" when, as here, reasonable minds cannot differ as to the importance of the omitted facts. *TSC Industries, Inc.* v. *Northway, Inc., supra,* 426 U.S. at 450.[10]

While it is true that, in reviewing a determination of materiality, findings of basic fact must be sustained unless clearly erroneous, an appellate court is obligated to consider for itself the legal import of basic facts found by the district court. See Pet. App. B-14; *SEC* v. *Bausch & Lomb Inc.*, 565 F. 2d 8, 15 (2d Cir. 1977); *SEC* v. *Texas Gulf Sulphur Co.*, 401 F. 2d 833, 849 n.11 (2d Cir. 1968), cert. denied, 394 U.S. 976 (1969). In the present case, contrary to petitioners' contentions (Pet. 13, 15), the court of appeals did not disagree with any of the basic facts found by the district court. Indeed, the court of appeals expressly agreed with the findings of the district court that the Peterson deal was not a final plan (Pet. App. B-16). The court of appeals rejected, however, the legal conclusion of the district court that because the Peterson proposal was not final it could not be material; the court of appeals correctly recognized that "a proposal need not

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[10]Petitioners' argument (Pet. 11 n.11) that the undisclosed information concerning the Peterson proposal was not material completely misses the point. Petitioners argue that by May 28, 1975, the first date on which a Southdown shareholder would have received Valhi stock under the spin-off, a reasonable investor would have attached little, if any, significance to the irrevocably abandoned Peterson proposal in making an investment decision concerning *Valhi* stock. But the court of appeals correctly recognized that the proper focus in determining the materiality of the Peterson proposal, before it had been abandoned, was its significance to a reasonable investor in making an investment decision concerning whether to purchase or sell *Southdown* stock. Southdown shareholders had to decide whether to buy, sell, or hold their Southdown shares prior to May 13, 1975, the record date on which the rights of Southdown shareholders to the Valhi stock would be determined. On that date, the Peterson transaction had not been abandoned.

be final or consummated in order to be relevant to shareholder decisionmaking." *Ibid.* See, *e.g.*, *SEC* v. *Texas Gulf Sulphur Co.*, *supra*, 401 F. 2d at 849; *SEC* v. *Shapiro*, 494 F. 2d 1301, 1306-1307 (2d Cir. 1974); *Rochez Bros., Inc.* v. *Rhoades*, 491 F. 2d 402, 408 (3d Cir. 1974). The court properly held that the materiality of an inchoate transaction depends upon "a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." See Pet. App. B-9 to B-10 (emphasis omitted), quoting *SEC* v. *Texas Gulf Sulphur Co.*, *supra*, 401 F. 2d at 849. See also *Harkavy* v. *Apparel Industries, Inc.*, 571 F. 2d 737, 741 (2d Cir. 1978); *SEC* v. *Shapiro*, *supra*, 494 F. 2d at 1305-1306.

The court of appeals correctly concluded on the record before it that the likelihood that the Peterson transaction would be effectuated was so substantial and was of such significance to shareholders trying to decide whether to buy, sell or hold Southdown's securities that its disclosure was essential. That proposal, whereby Valhi would have acquired a controlling interest in National Alfalfa and would have issued a controlling block of preferred stock to petitioner Mize and his associates, was a major event in the life of the corporation. Moreover, the two principal hurdles to the proposal, obtaining Peterson's approval and the necessary bank financing, had been surmounted by the date of the spin-off and by the time the prospectuses were in use. Indeed, even petitioner Mize admitted that the proposal would have been consummated but for shareholder lawsuits. Thus, the balancing engaged in by the court of appeals was not, as petitioners suggest (Pet. 10-11, 15-16), a *de novo* review of the findings of basic fact, but rather was the determination of an ultimate issue, *i.e.*, materiality, by applying the appropriate legal standard. The court of appeals

specifically recognized the weight to be accorded findings of fact by the district court and paid "due deference to the district court's finding" on the Peterson transaction (Pet. App. B-15). On the record before it, however, the court correctly determined that the legal balance tipped in favor of materiality and disclosure.[11]

CONCLUSION

The petition for writ of certiorari should be denied.

Respectfully submitted.

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[11]Petitioners also argue (Pet. 13) that the court of appeals erred in reversing the district court's denial of injunctive relief without any express finding that the district court abused its discretion. However, misapplication of the law is itself an abuse of discretion requiring reversal. See *e.g.*, *United States* v. *School District of Ferndale*, 577 F. 2d 1339, 1351 (6th Cir. 1978); *Milsen Co.* v. *Southland Corp.*, 454 F. 2d 363, 369 (7th Cir. 1971). See also *Union Tool Co.* v. *Wilson*, 259 U.S. 107, 112 (1922).

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APPENDIX

FEDERAL RULES OF CIVIL PROCEDURE

RULE 41

DISMISSAL OF ACTIONS

* * * * *

(b) *Involuntary Dismissal: Effect thereof.* * * * After the plaintiff, in an action tried by the court without a jury, has completed the presentation of his evidence, the defendant, without waiving his right to offer evidence in the event the motion is not granted, may move for a dismissal on the ground that upon the facts and the law the plaintiff has shown no right to relief. The court as trier of the facts may then determine them and render judgment against the plaintiff or may decline to render any judgment until the close of all the evidence. If the court renders judgment on the merits against the plaintiff, the court shall make findings as provided in Rule 52(a). Unless the court in its order for dismissal otherwise specifies, a dismissal under this subdivision and any dismissal not provided for in this rule, other than a dismissal for lack of jurisdiction, for improper venue, or for failure to join a party under Rule 19, operates as an adjudication upon the merits.